DB SCHENKER

By Appointment to Her Majesty The Queen Royal Train Operator DB Schenker Rail (UK) Ltd Doncaster

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Dear Gian Carlo,

Periodic Review 2013 : Establishing Network Rail's Efficient Expenditure.

This letter contains the response by DB Schenker Rail (UK) Limited ("DB Schenker") to the consultation document entitled "Establishing Network Rail's Efficient Expenditure" issued by Office of Rail Regulation ("ORR") on 26 July 2011.

Introduction

Since privatisation, the UK rail freight industry has been successful and :

- directly employs over 5000 people,
- keeps over 100 million tonnes of freight off the roads each year
- has attracted private sector investment of c £1.5bn
- has grown by some 50% in fifteen years, now representing a market share of surface transport of around 12% (up from 8% at privatisation).

It has done this in the face of adversity including :

- the collapse of the railway network in 2000
- the bankruptcy of Railtrack
- Government policy on the fuel duty escalator
- 44 tonne lorries.

Growth would have been even higher but for the recent global economic crisis & recession as prior to 2008, growth of 68% was achieved through a relentless pursuit of efficiency, striving towards customer satisfaction and strong control of costs as recognised by Sir Roy McNulty's "Rail Value for Money Study"

Both the Comprehensive Spending Review and McNulty reinforced Government's belief that;

- investing in rail freight helps to drive economic growth and supports key sectors of the economy
  - the movement of coal to power stations for electricity generation
  - the movement of key raw materials for industries such as steel

    - the movement of aggregates and cement into London and major conurbations for construction work
    - the movement of containerised goods between major ports/the Channel Tunnel and inland distribution centres.

- the rail freight industry delivers environmental benefits to the UK;
    - rail freight uses 70% less carbon per average tonne mile than road
    - rail freight's emissions are up to five times lower than road
    - rail presents greater decarbonising potential than any other traffic using the rail network.;

- the rail freight industry directly contributes about £870m to the nation's economy but the real economic impacts are much greater. The total contribution to the economy after also taking into account the indirect and induced effects is around £5.9bn per annum;

Rail freight currently faces a myriad of other uncertainties including :

- The continuing uncertain economic outlook, both in the UK and in the global financial markets and its effects on trade and the movement of goods.

- The cost of fuel, which has increased significantly over recent years.

- The rise in fuel duty, which has similarly increased.

- The recent decision by the Government to sanction extended and extensive trials of longer road semi-trailers.

- Increasing congestion on the national railway network which can limit the rail freight industry's ability to respond quickly to changing customer requirements.

- ORR's review of its policy on on-rail competition.

- Other transport initiatives that impact directly on the rail freight business - including the construction and operation of Crossrail and aspirations to introduce further long distance and high frequency passenger services on routes critical for existing and future rail freight.

- The continuing uncertainty about the attitude of other industry parties towards rail freight illustrated by both the current debate about the capability and capacity of the network for freight and the lack of transparency about Network rail / TOC bilateral Alliancing discussions as part of Network Rail devolution.

In the face of these uncertainties the rail freight industry continues to places great reliance on the ORR and the PR13 process to help us to deliver our plans and aspirations for significant growth.

Over the last 10 years, the rail freight industry has benefited from both the independence and support of the ORR for growing rail freight and the 2001 and 2009 freight charging reviews were critical elements. Rail freight operators therefore attach great importance to supporting the ORR's work in driving efficiency throughout Network Rail and wherever possible will share the techniques and successes underpinning the improvements in rail freight efficiency noted by McNulty.

Establishing Network Rail's efficient expenditure.

Taken overall, we support the ORR's proposed approach to establishing the revenue requirement for PR13, and the appropriate level of efficiency. We note the increased focus on bottom up analysis to support the top down work which we agree is likely to add weight to the analysis.

For freight, the experience of PR08 was that, whilst the data quality for the major routes was reasonable, the available cost information for minor routes and particularly for freight only lines was, at best, patchy. The modelled results from the Infrastructure Cost Model were, as a consequence, less than robust in some cases. Whilst we understand that different approaches are likely to be used for PR13, it will still be vital that data quality is sufficiently accurate. The disaggregation of costs by route makes this even more critical; Network Rail could not accurately assess freight only line costs on a national basis previously, so we would recommend ORR should ensure that any model proposed by Network Rail is fully fit for purpose.

We note that ORR will continue to use international benchmarking to support its assessment of Network Rail. We agree that a wider set of benchmarking parameters is appropriate, including companies outwith the rail sector, and with a closer assessment of the core reasons for efficiency gaps. At the workshop there was some discussion about the comparator data and the work that Network Rail is undertaking with other European rail infrastructure managers. Any such work must be mindful of structural and economic geography differences, and the potential for data reliability issues to arise in consequence.

We would make the following points :

1. We agree that separating support and operations expenditure is sensible, but suggest that ORR also needs to consider;
    a. Reviewing what has previously been funded (eg in CP3) but not yet delivered
    b. Analysing support and operations expenditure into staff and non-staff costs, and being clear about such costs vary with activity (or not as the case might be). In our experience surprisingly few costs are truly fixed and generally have some relation to activity, even if there is a long time frame to changing them.

2. Is ORR content that the base year data is representative? Can any one-off or transitional costs be accurately identified?

3. Is ORR satisfied at the categorisation of Opex and Capex used by Network Rail? Have these been consistent over the years being used for base data and are these representative of future years? Are all costs that are capitalised appropriate?

4. Where non-controllable or other Network Rail's costs are effectively "passed through" to TOCs/FOCs, eg with BTP network policing charges being part of Track Access, how will Network Rail be properly incentivised to reduce (or try to reduce) them?

    We understand that with some costs a whole-industry approach might be valuable, but would look to ORR to test robustly just how non-controllable many of these costs actually are.

5. How will the costs necessary to achieve efficiency (eg IT costs) be calculated and included?

6. We would support ORR testing Network Rail's Network Operating Strategy (NOS) in some detail – both in terms of scrutinising the business case and assessing when the benefits will be realised. This is because the NOS is so fundamental to the achievement of Operating Cost reductions and has such a potentially profound influence on the service delivered to TOCs/FOCs. Previous industry attempts at fundamental change - eg the original plans for the WCML – have not been smooth or successful and the earlier the NOS proposals are tested the better.

7. We support the use of funds (such as the SFN fund) where there are proper governance procedures. We believe that the SFN governance procedures generally work very well and we support the continued use of an SFN fund for CP5. We believe that this approach engenders teamwork and wider buy-in, and in the case of the SFN governance structure whole-industry involvement.

   We would recommend that the governance procedures apply equally to the sponsor role in projects and that key stakeholders are fully engaged and involved at the earliest stage of project development.

   This would help to ensure appropriate specification and guard against "gold plated" schemes or incorrect outputs. Involving stakeholders such as TOCs/FOCs at the earliest stage will also help to guard against inefficient costs becoming accepted as a more commercial focus will be brought in at a very early stage. This is what has happened with the early development of potential freight enhancement schemes for CP5 where initial NR ideas on outputs were supported, but the original estimates of possible cost were rejected as not representing commercial value for money,

8. We would also recommend a review of the GRIP processes and their effects. There is no doubt that the discipline of the GRIP process has brought some benefits and structure, but our experience is that there are also more negative unintended consequences. The rigidity of the process, with its inability to move back a stage other than by starting from scratch, is well known. It seems to us that it also engenders risk-aversion and has helped to inflate costs estimates through unnecessary levels of contingency being applied. As with all rigid processes there is a danger that the process itself becomes the aim of the exercise and the actual projects/intentions almost secondary.

   It may well be useful to set out transparently for representative projects how the GRIP process has worked – eg for some small, medium and large projects (including if possible projects to secure new freight connections to the network which are of particular interest to the rail freight industry), how both the outputs and costs changed at each GRIP level and how long each stage took.

9. With respect to the HLOSs, we understand the challenges of fully specifying all schemes at a point in time so far in advance of the control period commencing. We suggest that robust demand forecasts should be essential for all HLOS schemes. In addition, it is clear that changes in scope of enhancements are a major element in cost escalation and need to be avoided at all costs. We believe that TOC/FOC sign-off in advance of all potential HLOS schemes, together with demand forecasts, will add robustness to the process and minimise the risk of uncontrolled changes.

The HLOSs also need to acknowledge that there will be short term opportunities that will arise after they are published and there will need to be a process / some flexibility as to how these will be accommodated. Greater use of funds is one possible mechanism.

10. We also recommend that ORR consider decrements as well as increments, whether as part of maintenance/renewals or projects. RFOA has recently supplied NR with a list of routes where there is no current or foreseeable freight traffic to see if that will enable Network Rail to achieve maintenance or renewal efficiencies. However any such efficiencies would need to be clearly linked to pre-agreed changes in outputs or network capability and be subject to an agreed mechanism as to how capability could be expeditiously restored (and funded) if needed at a later date.

11. The relationship between enhancements/efficiencies/standards is complex and we believe more work is needed to understand whether standards are truly a blocker to efficiency or simply a convenient excuse (or somewhere in-between).

    It is clear that standards need to be capable of differentiation in the same way that the railway appears to be moving, under devolution, to greater potential differentiation and a more flexible approach to capability. As a national operator we have some concerns about this.

    Excessive route differentiation is likely to be a serious problem for cross-route operators and we urge ORR to exercise some care. Differentiation does not necessarily lead to efficiency – it can simply be code for output changes and we have some concerns that devolved routes will struggle to strike an appropriate balance between national and route priorities, especially where they might not understand the implications of some courses of action. One man's efficiency can easily be another's output reduction; equally the additional transaction costs caused to another party might not be visible in time to devolved decision makers.

12. We believe ORR should also review the relationship between outline/detailed workbank planning and the process for actually planning the delivery of work. It is well known that NR's renewals programme changes dramatically in the six months before delivery. Currently possessions are booked two years in advance – well before the detailed workbank planning is able to plan which specific work will be carried out. We receive outline plans for engineering trains from NR National Delivery Service some eight/nine months in advance – but this is frequently changed up to only days/hours before the commencement of work.

    We believe there is huge inefficiency in these processes and these drive great cost. Equally we see inefficiencies in the time (and therefore cost) of taking and handing back possessions and the extent to which Network Rail allows single line operation of train services whilst undertaking works on adjacent tracks(s). On certain routes, and with the agreement of the operators, it may also be possible to use such techniques during off peak daytime, to facilitate more efficient working practices. This is an example of an area where closer 'bottom up' analysis may be productive, if necessary coupled with input targets for delivering change.

Yours sincerely,

Nigel Jones
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